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In the Supreme Court of the United States

OCTOBER TERM 1946

No. .....

SOUTHERN PACIFIC COMPANY, a railroad corporation, Intervener,

Petitioner,

vs.

BERRYMAN HENWOOD, as Trustee of ST. LOUIS SOUTHWESTERN RAILWAY COMPANY LINES, et al.,

Respondents.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit

To the Honorable the Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioner Southern Pacific Company, appellant in the above-entitled case in the United States Circuit Court of Appeals for the Eighth Circuit, numbered 12883, therein, prays that a writ of certiorari issue to review the judg-

ment (R. 5559-5683) of that court in this case.[1] This judgment affirmed, with amendments not now material, an order (R. 5183-5213) of the United States District Court for the Eastern District of Missouri, which approved a plan of reorganization for St. Louis Southwestern Railway Company (hereinafter referred to as Debtor), certified by the Interstate Commerce Commission under Section 77 of the Bankruptcy Act (11 U.S.C. Sec. 205).

SUMMARY STATEMENT OF THE MATTER INVOLVED

The questions presented are:

1. Can application of an Interstate Commerce Commission reorganization plan, under which a carrier's stock is found to be without value and excluded from participation, be sustained as equitable, when, in the interim between the adoption and the time of application of the plan, the carrier, through payments of indebtedness and accumulation of net current asset balances, has ceased to be insolvent and has achieved solvency, in the bankruptcy sense, by a wide margin?

2. Can application of such a plan and valuation be sustained as equitable when, in the interim between its adop-

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(1) This case was decided by the Circuit Court together with companion cases No. 12882, *St. Louis Southwestern Railway Company v. Berryman Henwood;* No. 12884, *Horace A. Davis, Benjamin S. Lichtenstein and Sylvan Gotshal, as a Protective Committee for Holders of Central Arkansas & Eastern Railroad Company Bonds, vs. Berryman Henwood;* No. 12885, *Horace A. Davis, Benjamin Lichtenstein & Sylvan Gotshal, as a Protective Committee for Holders of Stephenville North & South Texas Railway Company Bonds vs. Berryman Henwood*; and No. 12886, *Walter E. Meyer v. Berryman Henwood.* All these cases were submitted to the Circuit Court on a consolidated record.

tion and application, the carrier's post-war peacetime net income has soared to a much higher plane than the earlier pre-war peacetime level considered by the Commission as the basis for its valuation?

3. Can a claim be completely excluded from participation in a railroad reorganization plan when, at the time the plan is to be applied, the carrier's assets are in excess of its other obligations, and at the same time its earnings are sufficient to justify a valuation recognizing the claim?

The questions are presented upon the following facts:

In its original plan of reorganization for the Debtor, set forth in its report of June 30, 1941 (R. 3495-3735), the Commission found the Debtor's value for new capitalization should not exceed approximately $75,000,000. Such capitalization was to be made up of certain existing first mortgage bonds left undisturbed and of new securities including 10 year four percent serial notes, consolidated mortgage 50 year four percent bonds, five percent preferred stock, and common stock to be distributed to creditors (R. 3733). Debt claims totaling $8,304,118 received no recognition within the limits of capitalization approved, and the existing preferred and common stock of the Debtor, of which petitioner holds a majority interest, was found to have no value and accordingly excluded from participation in the plan (R. 3700). The valuation in the original decision was challenged by several parties, including petitioner, but on March 9, 1942, the Commission, upon a submission to it of October 8, 1941, issued a supplemental report refusing to modify materially its previous valuation (R. 3736-3820, 5575).

In attacking this plan before the District Court and on appeal in the Circuit Court it has consistently been petitioner's position that Debtor's financial position and its earnings have undergone such an extreme improvement subsequent to the time when the Commission made its valuation as to render utterly inequitable the present application of the Commission's valuation and of its determination that the Debtor's stock was valueless. Particularly, before the Circuit Court, petitioner contended in its principal argument and in its petition for rehearing that the present application of the Commission's valuation was inequitable because of the following changed conditions developing subsequent to the Commission's supplemental decision: (1) the fact that there has been a very substantial reduction of long term indebtedness and a tremendous improvement in the balance of current assets over current liabilities with the result that the Debtor, which, at the time of the Commission's decision, was insolvent, in the bankruptcy sense of excess of liabilities over assets, by about $8,000,000, had now actually achieved a position of solvency in that sense by a wide margin; and (2) the fact that Debtor's post-war net railway operating income and income available for fixed charges, which are indicative of the long term future situation, are much higher than the comparable figures for pre-war years used by the Commission as the basis for its valuation (R. 5658, 5659, 5716-5727). This change of conditions, petitioner has insisted, required the plan to be remanded to the Commission for reconsideration in the light of the present picture.

The latest earning figure referred to in the Commission's supplemental report was of earnings to June 30,

1941 (R. 3739). There is in the record a copy of Debtor's balance sheet for August 31, 1941, (R. 4077, 4079) which we may assume shows approximately the assets being valued by the Commission in its supplemental report decided on a record submitted October 8, 1941. The latest statement made by the Commission as to Debtor's debt position was that in its supplemental report, setting forth the principal amount of such indebtedness with interest to January 1, 1942 (R. 3785).

In support of petitioner's contention that this record is now stale, it and the Debtor have sought to supplement the record by providing the District Court and the Circuit Court with the latest available balance sheets and income accounts for the Debtor subsequent to those considered by the Commission, a procedure accepted by this Court in *Ecker v. Western Pacific R. Corp.* 318 U.S. 448, 507. It appears that the District Court considered the revenues and financial condition of Debtor for 1941 and 1942, and, so far as then available, those for 1943 (R. 5654). In the Circuit Court a motion of the Debtor was granted to supplement the record with Debtor's income accounts for the years 1941 through 1944 and with its balance sheets for December 31 of each of those years (R. 5654). These matters were filed by the Debtor's trustee in the District Court in the regular routine procedure, and were considered by the Circuit Court (R. 5654). Petitioner attached as exhibits to its petition for rehearing, and submitted in evidence, copies of the Debtor's income accounts for 1945, and the first seven months of 1946, and of Debtor's balance sheets for December 31, 1945 and July 31, 1946 (R. 5719). In keeping,

with this practice petitioner has attached as Appendices A and B hereto, copies of the Debtor's income accounts for the first ten months of 1946, and its balance sheet for October 31, 1946, the latest such figures now available.

Comparison of these subsequent figures with those before the Commission reveals what an extraordinary improvement there has been in Debtor's asset and liability position since the Commission's decision. Debtor's balance of current assets over current liabilities as of August 31, 1941, and the total of its long term debt, including interest to January 1, 1942, which figures may be regarded, as indicated above, as those forming the basis for the Commission's valuation in its supplemental report, were as follows:

Net Current Asset Balance	$ 6,270,221.42[2]
Long Term Debt and Accrued Interest	83,243,764.00[3]

As of the time of the Commission's supplemental decision Debtor was found by the Commission to be insolvent in the bankruptcy sense by the amount of $8,304,118, the portion of its indebtedness receiving no recognition in the Commission's plan (R. 3700).

Considering the same items as shown by Debtor's balance sheet for December 31, 1944, the latest figures before

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(2) (R. 4077, 4079), Current assets were $9,199,570.33 and current liabilities were $2,929,348.91). There is excluded in this computation of total current liabilities the amount of $5,797,-558.36 "Loans and Bills Payable (In Default)" (R. 4079), which item is made up of notes to the Chase National Bank, the Mississippi Valley Trust Company and the Railroad Credit Corporation These items are excluded for the reason that they are included in the long term debt figures in the next line, to be refunded under the plan of reorganization (R. 3785).

(3) (R. 3785).

the Circuit Court at the time of the argument before it, the totals were as follows (R. 5738, 5739):

Net Current Asset Balance	$14,860,520.02
Long Term Debt and Accrued Interest in Default	77,861,776.47[4]

The total improvement in these figures over the comparable ones considered by the Commission is $13,972,286.13. Consequently, as of that date, the condition of insolvency by approximately $8,300,000 which had existed when the Commission made its decision had been completely changed, and Debtor was then solvent by approximately $5,600,000. Continued excellent earnings by the Debtor during the remainder of the war period and during the peacetime era since have enabled it to improve its financial position even more through reduction of its indebtedness and increase of its net current assets. Thus, as of October 31, 1946, the comparable net current asset balance and debt figures were as follows (Appendix B):

Net Current Asset Balance	$22,090,504.54
Long Term Debt and Accrued Interest in Default	71,944,971.96

(4) This figure represents the total of long term debt and interest in default reduced by $7,859,305.73, which is the total of $6,957,500, the portion of Debtor's $10,000,000 issue of second mortgage income bonds held in its treasury and of two open accounts with the Debtor's subsidiaries, Southwestern Transportation Co. in the amount of $890,289.51 and the S. W. Town Lot Corp. in the amount of $11,516.22. These items are properly excluded for comparative purposes, because the Commission excluded them in making its total debt determination as of January 1, 1942 (R. 3785), and because they are intra-system obligations. In additions made to footnote 20 of its opinion at the time the petitions for rehearing were denied, the Circuit Court recognized that the $6,957,500 amount of second mortgage bonds held in the treasury was not an outstanding indebtedness and should properly be eliminated (R. 5664-5665). The court overlooked eliminating the smaller amounts covering the open accounts, but for the same reasons they should also be eliminated.

The total improvement over those considered by the Commission as of the above date was thus $27,119,075.16. Debtor was then solvent by a margin of approximately $18,800,000.[5]

The case for the present solvency of the Debtor is presented upon the basis of reduction in debt and improvement in current liquid assets. It is not necessary to place reliance upon improvement in property account resulting during the trusteeship from the plowing of funds back into the property. However, by reason of investment of earnings in this property the road and equipment account increased from August 31, 1941 to October 31, 1946, by $12,727,394.21, from $123,849,919.48 to $136,577,-313.69 (R. 4077, Appendix B). This despite large write-offs because of abandoned lines and for amortization of war facilities. A substantial amount of this investment has been in rolling stock. Such investment, in diesel locomotives, new freight cars, etc. cannot be discounted. Ordinarily such purchases are financed to the extent of 80% of cost through equipment trust certificates or conditional sales but here the full purchase price was paid in cash.

Since October 31, 1946, the Debtor has further continued to retire its indebtedness. With the approval of the bankruptcy court, evidenced by order of September 3, 1946 (attached hereto as Appendix C), it retired on December 1, 1946, its Texarkana Union Station five percent certificates in the principal amount of $315,000.

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(5) Financial periodicals have clearly recognized Debtor's present solvency. Thus, in an article entitled "Cotton Belt Is Solvent Today," Standard & Poors Railroad Securities Weekly Outlook Section, December 27, 1945, pgs. B-87-88, it was said: "Whatever the decision, the reduction in claims and the vast improvement in the company's finances have made the I.C.C. plan obsolete . . . In other words, the company is solvent."

Considering in detail the whole debt picture, it is to be noted that Debtor has now paid off $15,105,483 of the principal and interest in default on its obligations funded under the Commission's plan (to January 1, 1942) as follows:

Equipment Obligations (R. 3785, 5739) Principal	$ 216,000
Texarkana Union Station 5's (R. 3785, Appendix C hereto) Principal	315,000
Railroad Credit Corporation (R. 3785, Appendix D hereto) Principal and interest to January 1, 1942	1,331,300
First Terminal and Unifying 5's (R. 3785, 5267, 5273-5274) Interest to January 1, 1942	2,620,475
General and Refunding 5's (R. 3785, 5268, 5274-5275, 5704, 5709) Interest to January 1, 1942	3,031,437
Second Mortgage 4's (R. 3785, 5265) Interest to January 1, 1942	791,050
Reconstruction Finance Corporation (Southern Pacific Co.)[6]	5,468,363
Chase National Bank[6]	1,035,887
Mississippi Valley Trust Co.[6]	295,971
Total	$15,105,483[7]

(6) The amount of interest on these obligations funded in the plan was as follows:

	Principal and Interest	Principal	Interest
Southern Pacific	$23,350,613 (R. 3781)	$17,882,250 (R. 3785)	$5,468,363
Chase National Bank	4,535,887 (R. 3781)	3,500,000 (R. 3785)	1,035,887
Mississippi Valley Trust Co.	1,295,971 (R. 3781)	1,000,000 (R. 3785)	295,971

Since these notes were secured by pledge of $30,230,000 of the Debtor's General and Refunding 5's (R. 3514), the interest payments made on the latter bonds to the pledgees subsequent to the submission of the case to the Commission have served to reduce the above notes. Inasmuch as interest has been paid on these bonds between January 1, 1936, and July 1, 1942 (R. 5268, 5274-5275, 5704, 5709), the total amount received by the

In addition, it has paid interest currently, accruing since January 1, 1942, on its First Mortgage bonds (never defaulted), its Second Mortgage bonds, and its Terminal and Unifying bonds, and has also paid interest on its Generals through July 1, 1942 (R. 5701, 5706).

When consideration is given to the Debtor's earnings, a factor which this Court has recognized as extremely important in making an evaluation for new capitalization purposes, the improvement between those of the pre-war era considered by the Commission and those of the war-time period, and particularly the post-war period, is equally impressive. Debtor's income available for fixed charges, as tabulized for the years from 1923 through 1944, is as follows (R. 5657):

1923	$5,929,628	1934	$ 2,024,891
1924	5,028,749	1935	2,695,111
1925	5,057,460	1936	3,333,243
1926	5,072,628	1937	2,304,505
1927	4,692,923	1938	2,088,299
1928	4,382,449	1939	1,199,158
1929	3,714,052	1940	2,860,221
1930	2,380,379	1941	7,495,940
1931	2,710,861	1942	8,692,636
1932	125,857(deficit)	1943	10,562,547
1933	1,840,184	1944	11,133,608

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above pledges has been $10,580,500, or well in excess of the funded interest to January 1, 1942 on their notes. This reduction in principal and interest has occurred, irrespective of whether the payments are applied to the principal of the notes, interest thereon, or to principal and interest pro rata.

(7) This figure does not take into account the situation with respect to interest accruals and payments made for the period subsequent to January 1, 1942. But the actual reduction, as of October 31, 1946, in the amount of Debtor's long term debt and interest, as it existed on January 1, 1942, is not less impressive, being $11,298,792.04 (pgs. 6, 7, *supra*.)

As pointed out in petitioner's petition for rehearing, the comparable figure for 1945 was $7,001,641.15 (R. 5727). In Appendix A hereto, the comparable figure for the first 10 months of the first full post-war year, 1946, is set forth, showing income available for fixed charges of $5,949,631.47. If the same rate of income is continued for the remainder of the year, the figure will again be approximately $7,000,000, as it was in 1945.

It is plain from the above that Debtor's post-war income available for fixed charges for the year 1946 will be far in excess of the same for any pre-war year considered by the Commission. It is anywhere from two to six times the comparable figures for the pre-war period from 1930 through 1940, upon which the Commission primarily relied (R. 3690). It is nearly three times the annual charges ahead of common stock of $2,451,228 (consisting of $1,513,723 interest and $937,505 preferred stock dividends) for which provision is made in the Commission's plan (R. 3785). It will be over two times the approximately $3,000,000 of interest charges upon existing debt (R. 5257).

Class I Railroads in the aggregate reported a *net loss* for the first six months of 1946 of $28,022,428, but the Debtor for this period had a net income of $1,433,669 after fixed charges (R. 5756,[8] I.C.C. Statement M-125, Selected Income and Balance Sheet Items for Class I Steam Railroads in the United States). Its existing fixed charges for this period were earned nearly two times over (R.

(8) These figures for the Debtor during the first six months of 1946 may be derived by subtracting the figures for July 1946, shown at R. 5756, from those shown at the same page for the period from January 1, to July 31, 1946.

5756). Thus the Debtor in 1946 has done much better than the average of this industry.

Debtor's tremendously increased income for the post-war period, as represented by 1946, cannot, like the "unreliable norm" of war earnings, be considered something merely temporary, or as a carry-over from the unprecedented earnings of the preceding war years. Instead it is explained by an extreme shift of population and business to the centers of California and Texas, notably Los Angeles, Houston, Dallas and Fort Worth, which Debtor serves either as a "bridge carrier" or directly from St. Louis. Judicial notice must be taken of the amazing population increase and industrial development[9] in these cen-

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(9) The United States Census Bureau reports that the population of Los Angeles as of January 28, 1946, was 1,805,687, an increase of 20 percent since April 1, 1940 (Census Bureau Report, Series P-SC, No. 119, April 10, 1946). The 1940 census shows the populations of Houston, Dallas and Fort Worth respectively, as 384,514, 294,734 and 177,662. According to estimates made, in the case of Houston, by utility companies, and, in the case of Dallas and Fort Worth, by their Chambers of Commerce, the 1946 populations of these same cities were respectively: 478,000, 425,000 and 235,117. This represents respective percentage growths of 16 percent, 44 percent and 25 percent. Total California and Texas population increases between April 1, 1940 and July 1, 1945, were respectively 27.7 percent and 5.8 percent, California showing the largest numerical gain of any state during that period, a gain of 1,600,000 (Census Bureau Report, Series P-46, No. 3). The same publication shows that the total population of the United States as a whole during the same period increased by only .2 percent.

The business growth of these cities has been equally impressive. For the first 10 months of 1946 the retail sales in Los Angeles, Houston, Dallas and Fort Worth were respectively: 27, 33, 34 and 24 percent higher than the comparable sales in those cities for the first ten months of 1945 (Census Bureau Monthly Retail Trade Reports, California and Texas, October, 1946.)

The *Monthly Business Review of the Federal Reserve Bank of Dallas*, Jan. 1, 1946, Vol. 31, Number 1, pgs. 3-4, makes the

ters in relation to the rest of the country, which, while undoubtedly war induced, is likely to continue for the long term peacetime future. Account must also be taken of the action of the Interstate Commerce Commission in

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following observation in an article entitled "Post-war Prosperity in the Southwest":

> "This regional area experienced a greatly accelerated industrial expansion and development during the war years, the rate of growth having been above the average rate of expansion for the country as a whole.
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> Several developments of the war period seem to indicate favorable prospects for industrial expansion in the Eleventh District. Certainly among the most significant results of the wartime industrial growth in this District is that a skilled industrial labor force has been developed. Equally important is the fact that the war production experience taught a great many small producers the productive and managerial skills which are essential in an industrial area and which may serve as a foundation upon which a healthy, lasting postwar industrial growth may be developed. The rubber industry has been brought to this district, while the chemical industry has been greatly expanded. This district supplied a large part of the nation's petroleum requirements during the war, and the refining facilities of the area have been substantially increased. It is quite probable, therefore, that in the future a larger proportion of our petroleum may go out of this area in the form of refined products, thus giving to the area the gain of value added by processing. It is also likely that some part of the wartime gain in aircraft construction and shipbuilding may be retained. Certain of the smaller aircraft plants in the area, either already have converted to civilian production or are in the process of doing so.
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> Despite the very liquid current financial condition of business and industry in the area, the probability of a higher level of postwar economic activity in this district as compared with prewar levels indicates a favorable loan outlook for the banks of the area. Attraction of new industries to the Southwest and a possible increase in the number of small businesses further support this view."

Senator Wheeler has clearly recognized that the improvement in the financial picture of the carriers in the Southwest is due to fundamental changes in economic conditions in that area. Thus

its decision of December 5, 1946, in *Ex Parte No. 162, Increased Railway Rates, Fares and Charges, 1946,* and *Ex Parte No. 148, Increased Railway Rates, Fares and Charges, 1942,* which permits increases of basic freight rates by 20 percent for the future and permits continuation of previously granted passenger fare increases. These factors all lead to the inescapable conclusion that Debtor's permanent post-war earning power is now and will be at a much higher level than that envisaged by the Commission when it formulated the reorganization plan.

Despite this unprecedented showing which was made in support of petitioner's two principal contentions mentioned above, the Circuit Court rejected them, as indicated by the following language from its opinion:

(R. 5662-5663)

> "First, accent is placed upon the solvency of Debtor, as claimed to be shown by the above and related statistics from balance sheets of Debtor and elsewhere. By solvency they mean balance of assets over debts. Solvency in that sense is far from con-

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he declared at the hearings before the Senate Committee on Interstate Commerce on S. 1253, the so-called Wheeler-Reed bill, considered *infra* pgs. 18, 37-41 (79th Cong. 2nd Session, March 7, 1946), pg. 515:

> "The vastly improved situation comes not only from increased earnings but takes into account economic conditions which have changed in certain parts of the country. Here we have Texas, which had Jesse Jones up in the RFC; a tremendous number of factories have been built in that State.
>
> You have had this changed economic situation. You have had it in Colorado, in Texas, Missouri, and all through that section, so that even though in peacetime some of those roads in the Southwest are going to enjoy more traffic. And then I think you are bound to get a decentralization of some of the industries in the East; they are bound to move to the West, not only for the welfare of the particular industry but for the welfare of the Country."

trolling in railway reorganization proceedings. The lack of solvency which justifies initiation of reorganization of railroads is inability to meet debts as they become due. The purpose of such proceedings is to produce a capital structure—as to amount and character—which will warrant continued ability, for a long period, to serve the public properly and to pay debts as they may mature and probably leave something for the new stock (*Reconstruction Finance Corporation, et al., v. Denver & R.G.W. R.R. Co., et al.,* ..... U.S. ..... June 10, 1946, "In conclusion" paragraph; *Consolidated Rock Co. v. Du Bois,* 312 U.S. 510, 525). The fact that the physical properties, including cash and liquid securities, may have a value beyond the total indebtedness is not controlling either at the beginning or during such reorganization proceedings. The only place for bettered conditions after formation of a Plan by the Commission, is where such conditions have so altered the situation as to make the Plan inequitable to existing creditors or stockholders (*Reconstruction Finance Corporation, et al., v. Denver & R.G.W. R.R. Co., et al.,* ..... U.S. ..... June 10, 1946). Solvency in the sense of balance of assets over liabilities has small bearing on such equity.

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(R. 5669)

Also, our problem is not whether these actual and potential funds *might* make an increased valuation and capitalization better than those of the Plan. It is whether, if the Commission had before it all that has come in to the record before the District Court and before us, it would be arbitrary for it to adhere to its present Plan. That these much improved conditions as to cash, liquid assets and potential tax refunds *might* alter the picture as seen by the Commis-

sion at the time of its reports seems true. However, that they *must* do so because otherwise the sight of the Commission would have to be declared arbitrary, we think is not true.

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(R. 5658)

It is urged that though there will be a falling off in revenue at the end of the war, yet there will be an increase of business for Debtor over that before war. The argument is that the increase in population into this territory during the war will result in many of these newcomers remaining; and that many of the numerous war industries established there will be converted into peacetime uses. These results may occur but the measure of them is not even estimated. Such uncertain elements can find no place in estimated future earning for reorganization valuation purposes."

The court was correct in its statement above that no measure of these post-war changes was made, insofar as the principal argument was concerned. Such an estimate would have been impossible at the time of the argument, which was held before the end of the war. But such an estimate, represented by the earnings figures for 1946, set forth above, up through July 31, was submitted in petitioner's petition for rehearing (R. 5719, 5756). No comment on this question in the light of these figures was made by the court in its order dismissing the petition (R. 5831).

REASONS RELIED ON FOR GRANTING THE WRIT

1. The Circuit Court, in holding adversely to petitioner's contentions on the first two questions above, has decided important questions of federal law which have not been but should be decided by this Court. This Court has recognized that unanticipated changed economic conditions since the adoption of a reorganization plan by the Commission must be considered by the reviewing court and may be so extreme as to require the plan to be remanded to the Commission. *Ecker v. Western Pacific R. Corp., supra,* 506-509; *Group of Investors v. Milwaukee R. Corp.,* 318 U.S. 523, 542-544; *R.F.C. v. D.&R.G.W. R. Co.,* 90 L. Ed. 1134, 1143. While in those cases it has recognized that the existence of the intervening increased wartime earnings was not enough alone to require the plan to be set aside, it has not yet finally determined what more extreme changes of conditions may require setting aside a plan. Opinion of Mr. Justice Reed of August 6, 1946 in granting stay in *In re Equitable Office Building Corporation, Debtor,* (D.C.S.D. N.Y., No. 78,476) (Nos. 609 and 610, this Court, October term, 1946). Here the changes and the financial improvement have been so much more extreme than in any of those cases as to place the present case in an entirely different category. Unlike the situation in those cases, the long continued wartime earnings have been transmitted into debt reductions and accumulations of current asset balances, to a point where there is now actual solvency in the bankruptcy sense. In none of those cases, nor in any others, has the significance of intervening solvency in that sense been considered. So far as the second question is concerned, that question is also entirely

different from that considered in the earlier cases, since here earnings of a permanent peacetime nature much higher than those considered by the Commission are presented, whereas in those cases the intervening improved earnings were merely of the evanescent wartime type.

The importance in railroad bankruptcy administration of the whole question of whether stockholders' equities are now to be wiped out in the face of intervening greatly improved financial conditions is shown by the passage at the last session of Congress of the so-called Wheeler-Reed Bill (S. 1253). Under this legislation existing railroad reorganization plans would have been rejected and the debtors would have been allowed an 18-month period in which to accomplish agreement upon their plans of reorganization with the various interests involved. Although the bill was vetoed by President Truman, his veto message indicated that he was not opposed to the aim of the legislation, to prevent forfeiture of railroad securities in the reorganization process. Congressional leaders have publicly indicated that efforts to enact similar legislation will be forthcoming in the next session of Congress. It is significant that throughout the legislative hearings on this bill the present Debtor's case was cited as a *cause celebre* on the issue of the inequity of eliminating junior interests under present conditions.

2. In connection with the first question above, the Circuit Court's decision is in conflict with that of a District Court in another circuit. The District Court for the Northern District of Illinois in a memorandum opinion of June 28, 1946, in *In the Matter of Chicago, Rock Island and Pacific Railway Company, Debtor,* (D.C.N.D. Ill., No.

53209) (attached hereto as Appendix E)[10] remanded a plan of reorganization to the Commission, because of intervening financial improvement, as evidenced by debt retirement and increase in net asset balance, although that carrier had not attained the solvent position which this Debtor has now achieved.

3. As to the third question, the Circuit Court's conclusion that the Debtor's stock interest should be totally eliminated despite the existing conditions, amounts to a decision of a question of federal bankruptcy law which is in conflict with the decisions of this Court in *Ecker v. Western Pacific R. Corp., supra,* 475-476 and *R.F.C. v. D. & R.G.W. R. Co., supra,* 1141. The Circuit Court has brushed aside almost completely, the factor of intervening solvency in the bankruptcy sense in determining whether a stock claim is now valueless. It has said that the value of a claim is to be determined almost entirely by future earning power. Tested by that criterion also, the stock is obviously not valueless. Consequently, the Circuit Court's decision in effect amounts to a determination that a claim which is not valueless may be eliminated in a railroad bankruptcy reorganization. This is contrary to the statements of this Court in the above cases that only valueless claims may be eliminated.

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(10) This opinion was also attached as an exhibit to petitioner's petition for rehearing (R. 5759).

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari be granted.

Dated: January 13, 1947.

BEN C. DEY
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In the Supreme Court of the United States

OCTOBER TERM 1946

No. .....

SOUTHERN PACIFIC COMPANY, a railroad corporation, Intervener,

Petitioner,

vs.

BERRYMAN HENWOOD, as Trustee of ST. LOUIS SOUTHWESTERN RAILWAY COMPANY LINES, et al.,

Respondents.

Brief in Support of the Petition

OPINION BELOW

The opinion of the Circuit Court below (R. 5659-5683) is reported at 157 F.(2d) 337. The District Court's opinion (R. 5183-5213) is reported at 53 F. Supp. 914.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 26, 1946 (R. 5681). On September 9, 1946,

the court issued an order (R. 5683-5684) extending to September 25, 1946, the time for filing petitions for rehearing, which time under the court's rules would otherwise have expired on September 10, 1946. Petitioner filed a petition for rehearing on September 23, 1946 (R. 5711-5765), which was denied by order of October 22, 1946 (R. 5831). Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C. sec. 347(a)) and under Section 24 of the Bankruptcy Act, as amended (11 U.S.C. sec. 47 c). The latter section specifically gives this Court jurisdiction to review judgments of the Circuit Courts of Appeals in bankruptcy proceedings, which is the nature of the judgment here sought to be reviewed. Cases believed to sustain this court's jurisdiction include the following: *Ecker v. Western Pacific R. Corp.*, 318 U.S. 448; *Group of Investors v. Milwaukee R. Co.*, 318 U.S. 523; *R. F. C. v. D. & R. G. W. R.R. Co.*, 90 L. Ed. 1134.

STATUTE INVOLVED

Section 77(e) of the Bankruptcy Act (11 U.S.C. sec. 205(e)) is here involved. Because of its length, it is reproduced as Appendix F to this brief.

STATEMENT

A statement of the matters involved is contained in the petition, *supra*.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In sustaining present application of the Commission's reorganization plan, as not inequitable to Debtor's stockholders, excluded from participation therein, when, in the interim between its adoption and the time of its application, the Debtor, through payments of indebtedness and accumulation of net current asset balances, has ceased to be insolvent and has achieved solvency, in the bankruptcy sense, by a wide margin.

2. In holding that intervening solvency in the sense of balance of assets over liabilities has small bearing on the equity to stockholders of present application of this plan under which they were denied participation.

3. In sustaining application of such plan, as not inequitable to stockholders, when, in the interim between its adoption and application, Debtor's post-war peacetime net income has soared to a much higher plane than the earlier pre-war peacetime level considered by the Commission as the basis for its valuation.

4. In holding that unprecedented industrial and population growth in the area served by the Debtor can find no place in estimated future peacetime earnings for reorganization valuation purposes.

5. In completely excluding Debtor's stockholders' claim from participation in the reorganization plan, when, at the time the plan is to be applied, Debtor's assets are in excess of its other obligations, and, at the same time, its earnings are sufficient to justify a valuation recognizing the claim.

6. In recognizing, in effect, that a claim which is not valueless may be lawfully excluded from participation in a reorganization plan.

SUMMARY OF ARGUMENT

1. The Circuit Court, in holding adversely to petitioner's contentions on the first two questions presented by the petition, has decided important questions of federal law which have not been but should be decided by this Court.

A. There can be no doubt that Debtor has experienced a vast financial improvement since the Commission's decision. It has progressed from a state of insolvency, by a margin of approximately $8,300,000 at the time of the Commission's decision, to a present state of solvency, in the bankruptcy sense, by a margin of at least $18,800,000.

Contrary to the Circuit Court's views, this present balance of assets over liabilities greatly bolsters Debtor's potential earning power. Such accumulation of assets may be used, as Debtor has, in fact, used earlier accumulations, either (1) to pay off the principal of existing indebtedness, so that future net income will not be depleted by interest charges on such indebtedness, or (2) to be plowed back into the business in the form of improvements in service, equipment and efficiency, so that future gross and net earnings will again be increased. In view of the importance of earning power as a criterion for valuation purposes, it is evident that the existence of this present solvent condition which directly enhances earning power, is, contrary to the Circuit Court's position, extremely signi-

ficant in determining the present equity of applying the plan. The present valuation eliminating Debtor's stockholders is grossly inequitable in that it necessarily did not take into account this intervening improved condition.

Apart from its present solvency, Debtor's actual peacetime earning power is substantially above that of the pre-war era considered by the Commission as the basis of its valuation. This is evident from the fact that its 1946 net income available for fixed charges is from two to six times the comparable figures for the pre-war period relied upon by the Commission, and is better than that of the railroads generally. Such high peacetime earnings, unlike war earnings, may be considered a reliable gauge of Debtor's long term future because of the intervening phenomenal industrial development and population growth of the area served by Debtor, and because of the recent action of the Interstate Commerce Commission in awarding substantial rate increases generally to railroads. The Circuit Court erred in dismissing these fundamental industrial and population changes as uncertain elements having no value as an aid to the estimation of future earnings for valuation purposes.

The plan is also grossly inequitable in the light of this great increase in the long term level of Debtor's earnings. This is evidenced by the fact that Debtor's 1946 income available for fixed charges is nearly three times an amount equalling the annual charges ahead of common stock which the Commission found would suffice to service its prescribed capitalization.

B. In the *Western Pacific, Milwaukee,* and *Denver & Rio Grande* cases this Court has recognized that intervening unanticipated changes in economic conditions may be

so extreme as to require a reorganization plan to be remanded to the Commission, although it found that the particular changes in those cases were not of this nature. The question as to what more extreme changes may require setting aside a plan was left open. The fact that Debtor has attained solvency and the fact that its post-war peacetime earnings are at a much higher level than the pre-war level constitute changes so much more extreme than the changes in the above cases, as to place them in an entirely different category. In none of those cases was an increased level of earnings of a peacetime variety presented. In none of them had the situation progressed to a point where there had been substantial debt reductions. In none of them had the carriers achieved or even closely approached a condition of actual solvency in the bankruptcy sense.

C. The importance in railroad bankruptcy administration of the whole question of whether stockholder equities are to be wiped out is shown by the passage at the last session of Congress of the so-called Wheeler-Reed bill (S. 1253). This legislation, which would have required the rejection of existing reorganization plans, was impelled by wide-spread public complaint against the tendency of existing plans to eliminate stockholder interests. Although the bill was vetoed by the President, he indicated at the time that he was in agreement with the aim of the legislation to prevent forfeiture of railroad securities. Congressional leaders have indicated that similar legislation, modified to meet the President's objections, will be presented at the new Congress. It is highly significant that throughout the Congressional hearings the present Debtor's plan was constantly referred to as a particularly flagrant

example of erroneous elimination of equity interest. Clearly, if any changes are of a magnitude to require setting aside a plan, and if this Court's statements in the earlier cases are not meaningless dicta, then the changes in the present case are of this type.

2. The Circuit Court's decision is in conflict with that of a District Court in another circuit, namely that of the District Court for the Northern District of Illinois in *In the Matter of the Chicago, Rock Island and Pacific Railway, Debtor,* (D.C.N.D. Ill., No. 53209). In that case a reorganization plan was set aside because of a showing of debt reduction and asset balance improvement, which, while impressive, had not brought that carrier to the solvent state occupied by Debtor.

3. The Circuit Court's decision is in conflict with the decisions of this Court in the *Western Pacific* and *Denver & Rio Grande* cases. It is evident from the Circuit Court's decision that it largely rejected solvency in the bankruptcy sense as of importance for valuation purposes in favor of an actual earnings test. Even from the standpoint of actual earnings it is clear that the stockholders' claim cannot reasonably be considered valueless. Under the circumstances, the Circuit Court's decision amounts to a holding that even a claim which is not valueless may be eliminated from participation in a reorganization plan. This is contrary to the statements of this Court in the above two cases that only valueless claims may be thus eliminated.

ARGUMENT

1. THE CIRCUIT COURT, IN HOLDING ADVERSELY TO PETITIONER'S CONTENTIONS ON THE FIRST TWO QUESTIONS PRESENTED BY THE PETITION, HAS DECIDED IMPORTANT QUESTIONS OF FEDERAL LAW WHICH HAVE NOT BEEN BUT SHOULD BE DECIDED BY THIS COURT.

A. There Can Be No Doubt That Debtor Is Today Solvent in the Bankruptcy Sense by a Large Margin, that Its Permanent Post-War Peacetime Earning Power Is Greatly in Excess of the Pre-War Earning Power Considered by the Commission as the Basis of Its Valuation and that the Existence of Either of These Conditions Makes Present Application of the Plan With Its Elimination of Stockholder Participation, Grossly Inequitable.

As shown in the statement in the petition, Debtor, in the years since the Commission's supplemental decision, through retirement of its debt and accumulation of a large net current asset balance, has achieved a truly impressive financial improvement. It has progressed from insolvency at the time of the Commission's decision by about $8,300,000 to solvency by at least $18,800,000, as of October 31, 1946.

The Circuit Court in its opinion endeavors to minimize this improvement by pointing out that petitioner has understated Debtor's outstanding indebtedness by $11,901,930, as of October 31, 1944 (R. 5670-5671). This figure represents the difference between the principal and interest due on the notes owned by Southern Pacific Company, Chase National Bank and Mississippi Valley Trust Company and the principal and interest due on the Debtor's General and Refunding bonds pledged as security for such notes. This difference, says the court, is allowable to these creditors under *In re Chicago & N. W. Ry.*

Co. (C.C.A. 7), 126 F. (2d) 351, cert. denied 318 U.S. 793, and *In the Matter of New York, N. H. & H. R. Co.* (C.C.A. 2), 147 F. (2d), 40, 47-48, cert. denied 325 U.S. 884.

In answer to this contention it may be said first that even if the court is completely correct, owing to the continued improvement in Debtor's condition, if the above $12,000,000 item is deducted from its margin of solvency of $18,800,000 (as of October 31, 1946), it would still be solvent in the bankrupty sense by the substantial margin of $6,800,000. Furthermore, it is to be noted that the Commission in its report has not so dealt with this matter. How it should deal with the notes and collateral under these circumstances may be determined by it if the plan is referred back to it. This question, like questions of the amount and type of capitalization, is, so long as the Commission follows legal standards, an administrative question with which the courts should not attempt to deal in the first instance. Cf. *Ecker v. Western Pacific R. Corp., supra,* 473; *Group of Investors v. Milwaukee R. Co., supra,* 544. Certainly the existence of the collateral will be duly recognized in the reorganization, but this may be by improvement in the quality of the security given to the note holders or by the payment of the notes in cash as was done in *Erie R. Co., Reorganization,* 239 I.C.C. 653, 724. It is not necessarily true that the creditor claims ahead of the stock will be expanded by reason of the pledge of collateral to secure the notes.

It may be readily demonstrated just how Debtor's intervening accumulation of a substantial net current asset balance, its substantial debt reductions and its present solvent condition in the bankruptcy sense, make the exclusion of stockholders in the proposed plan grossly in-

equitable. The Circuit Court has erroneously taken the position that there is little connection between solvency in this sense and the Debtor's earning power. Consequently, since that court regards earning power as the paramount criterion for reorganization valuation purposes, it has erroneously concluded that solvency in the sense of balance of assets over liabilities has small bearing on the present equity of the plan (R. 5662-5663). In point of fact there is a very close connection between solvency in this sense and the Debtor's potential earning power. These accumulations of assets may be used in two ways: (1) to pay off the principal of existing indebtedness (as Debtor has done in the past) so that future net earnings, which would otherwise have to be depleted by interest charges, will be increased; (2) to be plowed back into the business in the form of countless improvements in service, equipment and efficiency (as the Debtor has done also), so that future gross and net earnings will be increased. In either event the existence of this solvent condition greatly bolsters Debtor's potential earning power and the present worth of such earning power. Plainly apparent is the inequitable nature of Debtor's reorganization plan providing for a present worth valuation excluding stockholders, which necessarily did not take into account this subsequently developing improved condition.

Ironically enough, furthermore, the retirement, since the formulation of the plan, of a substantial amount of Debtor's indebtedness, which makes the $75,000,000 valuation inequitably low, may, under the provisions of the plan, result in an even lower capitalization for Debtor. This follows from the provision of the Commission's supplemental order (R. 3790) that the $75,000,000 capitaliza-

tion is "subject to variation to the extent, if any, that matured interest proposed to be funded in the plan is paid, —and as equipment obligations or other liabilities are paid or reduced . . ." This language is open to the interpretation that the total capitalization of Debtor is to be reduced by such amounts. As pointed out in the petition (pg. 9), Debtor has now paid off a total of $15,105,483 of principal and interest which was funded in the plan. Consequently, it is possible, if the existing plan is now put into effect, that Debtor's capitalization will be only about $60,000,000, and the already extreme inequity of the plan will be heightened by about $15,000,000. The plain truth is that the plan is obsolete and unworkable and the sooner it is returned to the Commission for revision, the better are the chances of the Debtor's emerging from reorganization.

Nor can there be any doubt that, apart from its present solvency, Debtor's actual long term post-war earning power is substantially above that of the pre-war era considered by the Commission as the basis for its valuation. As pointed out in the statement (petition, pg. 11), Debtor's income available for fixed charges during the full peacetime year 1946 will probably be about $7,000,000, anywhere from two to six times the comparable figures for the pre-war period from 1930 through 1940, upon which the Commission primarily relied. It is especially significant that, as the petition shows (pg. 12), the Debtor's post-war earnings are, on the evidence to date, much better than those of the railroads generally. Such earning power, as also pointed out in the petition (pgs. 12-14), because of the phenomenal industrial development and population growth of the area served by Debtor, and the

recent award by the Interstate Commerce Commission of substantial increases in rates to the railroads generally, bids fair to continue for the indefinite future. On the face of things, it plainly is not rational to dismiss such substantial population and industrial changes, in the Circuit Court's cavalier fashion as "uncertain elements" which "can find no place in estimated future earnings for reorganization valuation purposes" (R. 5658). Debtor's greatly increased post-war peacetime earnings, based as they are, on such fundamental economic changes, have a much sounder basis for permanence than the unprecedented high wartime earnings which this Court has heretofore in the *Milwaukee* and *Western Pacific* cases regarded as purely temporary and as an "unreliable norm" for the indefinite future. It is difficult to see why these post-war earnings should not be regarded as a much more reliable gauge for the long term future than the earnings of the "Dust-Bowl" era upon which the Commission necessarily relied.

The plan is also grossly inequitable in the light of this great increase in the post-war level of Debtor's earning power over the pre-war level considered by the Commission as the basis for its valuation. As pointed out in the petition (pg. 11), Debtor's 1946 income available for fixed charges, about $7,000,000, is nearly three times the annual charges of $2,451,228 ahead of common stock (consisting of $1,513,723 interest and $937,505 preferred stock dividends) which the Commission found would suffice to service its prescribed pre-war based capitalization. Patently under these circumstances the Commission's position that the Debtor's earnings will not comfortably support a higher valuation which would give something

to its stockholders is completely without rational basis. The inequity of the plan from this standpoint is further accentuated when consideration is taken of the fact, now well recognized, that interest rates on new capital are now generally considerably lower than they were during the pre-war period considered by the Commission. Consequently, the Debtor's bonds provided for in the plan could be readily refunded with lower interest bonds, so that in actual fact the same amount of net earnings in the future could satisfy the annual charges on a considerably higher capitalization than was the case when the Commission prescribed Debtor's capitalization.

B. The Questions Presented Have Not Been But Should Be Decided By This Court.

This Court has consistently recognized that unanticipated changed economic conditions since the adoption of a reorganization plan by the Commission must be considered by the reviewing court and may be so extreme as to require the plan to be remanded to the Commission. *Ecker v. Western Pacific R. Corp., supra,* 506-509; *Group of Investors v. Milwaukee R. Corp., supra,* 542-544; *R.F.C. v. D. & R.G.W. R. Co., supra,* 1143, 1148. Although in those cases the particular changes in conditions were held not to require the plans to be set aside,[11] it is evident that this

(11) Mr. Justice Frankfurter issued a subsequently published dissenting opinion in the *Denver & Rio Grande* case, reported at 91 L. Ed. 22. He took the position that irrespective of whether the changed conditions made application of the plan intrinsically inequitable, they did afford reasonable justification for the action of a particular class of creditors in rejecting it. That plan had reached an administrative stage beyond the present one, having been submitted to a vote of the various classes of creditors, and having been judicially confirmed over the dissenting vote of one class of creditors. Justice Frank-

Court has not settled the question as to what more extreme changes may require setting aside of a plan. Thus Mr. Justice Reed who wrote the opinion in two of the above cases remarked on August 6, 1946, in an opinion granting a stay[12] in *In Re Equitable Office Building, Debtor*, D.C.S.D. N.Y., No. 78,476) (Nos. 609 and 610, October term, 1946, in this Court):

> "The effect of unanticipated changes of economic conditions after confirmation on the propriety of subsequent action by the reorganization court to protect the interests of junior creditors also has not been judicially determined finally. Compare *R.F.C. v. D. & R.G.W. R. Co.*, 90 L. Ed. 1134, 1148; *Ecker v. W.P.R. Co.*, 318 U.S. at 506-509."

The changes of economic conditions in the present case ((1) payment of debts, development of a net current asset balance, so that insolvency has been changed to solvency by a wide margin, and (2) post-war peacetime earnings at a much higher level than the pre-war earnings considered by the Commission) are so much more extreme than those considered in the above three cases as to place them in an entirely different category. In none of those cases

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furter was considering the further condition in Section 77 of the Bankruptcy Act, not involved at the present stage, that where any class of creditors has rejected a plan, it can prevail only where the District Court finds that such rejection "is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts."

(12) Although this Court denied certiorari of the District Court's decision involved in that case on November 25, 1946, (Nos. 609 and 610), it did not disturb the stay, which will presumably continue in effect until an appeal taken in the same case to the Circuit Court has been disposed of and until an application for certiorari from the latter decision has been passed upon.

was the question of the significance of an increased level of permanent peacetime earnings presented, the earnings there involved being only of the temporary wartime nature. In none of those cases had the situation progressed to the further step where wartime earnings were converted, as they have been here, into substantial debt reductions. In none of those cases had there been even a close approach to actual solvency in the bankruptcy sense, such as exists here, so that the question of the significance of intervening solvency in this sense, here presented, was not there involved.

That there had not been an approach to solvency even in the *Rio Grande* case, wherein the improvement was greater than in any of these earlier three cases, is readily demonstrated by an examination of the facts of that case, as they appear in this Court's decision (90 L. Ed. 1138, 1144). The capitalization adopted for the Rio Grande, without consolidation with the Denver & Salt Lake, effective December 31, 1942, was approximately $143,000,000. On that same date, the total of long term debt and deferred liabilities was approximately $175,000,000 and the balance of current assets over current liabilities, reflected in the above capitalization, was approximately $7,000,000. The road was then clearly insolvent, in the sense of balance of liabilities over assets, by about $32,000,000. By December 31, 1944, there had been a considerable improvement on the asset side. There was now a current asset balance over current liabilities of about $12,000,000, an improvement of $5,000,000 over the previous balance. There was also a net addition to capital account of about $30,000,000. This $35,000,000 improve-

ment in assets would have wiped out the previous insolvency, except for the fact that the total of long term debt and deferred liabilities had in the meantime increased by $9,000,000 to $184,000,000. Consequently, the road, though in greatly improved condition as a result of earnings in the two-year period subsequent to the effective date of the plan, was still insolvent by $6,000,000.

The *Rio Grande* case is sharply distinguishable on yet another round, namely, that the changes there were anticipated by the Commission, whereas those now presented could not have been. That this factor was the real reason for this Court's refusal to remand the plan in that case is evidenced by the following statement from its opinion (90 L. Ed. at 1148):

> "Assuming that the courts, as courts with equity powers in a bankruptcy matter, might set aside a plan, fair and equitable when adopted by the Commission, merely on account of subsequent changes in economic conditions of the region or the nation, it should not be done when the changes are of the kind that were envisaged and considered by the Commission in its deliberations upon or explanations of the plan."

In that case the Commission's approval of the plan was entered on June 14, 1943, a year and a half after hostilities had been going on, and the wartime improved conditions relied upon extended only through December 31, 1944. There was some reason to surmise that with that much wartime experience before it, the Commission could have foreseen what the carrier's wartime future would have been. Contrast that situation with the one now presented. Here the Commission's last order was entered on

March 9, 1942 on a submission of October 8, 1941, so that the Commission could consider only pre-war conditions, or, at the most, conditions during the first three months of hostilities. Furthermore, the changed conditions involved extend to a much more distant time, that of the peacetime era of 1946. It seems beyond comprehension that the Commission could have foreseen, on the basis of this pre-war record, what cataclysmic changes in Debtor's economy would have been wrought before peace once more returned.

C. The Questions Presented Are Important In the Administration of the Federal Bankruptcy Act.

The importance in federal railroad bankruptcy administration of the whole question of whether stockholder equities are now to be wiped out in the face of intervening greatly improved financial conditions is shown by the passage at the last session of Congress of the so-called Wheeler-Reed bill (S. 1253). Under this legislation, existing railroad reorganization plans would have been rejected and the debtors would have been allowed an 18-month period in which to accomplish agreement upon their plans of reorganization with the various interests involved.

That there was terrific public pressure behind this legislation and that the reason for this pressure was primarily the elimination of stockholder interests despite intervening greatly improved financial conditions of the carriers, is evidenced by the following statements at the hearing on this bill by Senator Wheeler, Chairman of the Senate Committee on Interstate Commerce, and one of the sponsors of the legislation:

"The Chairman. The reason we have tried to work out something in this committee is because of the terrific pressure that has been put on the committee and the Congress by Members of the Senate and their own constituents to pass the Hobbs bill. We have tried to work out something not as drastic as the Hobbs bill."[13]

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"If you had not had these changed conditions there would not have been this complaint we have from all the country, from stockholders and bondholders and everybody else. I just don't believe that the Commission ought to hesitate at all to say that in view of the changed conditions there ought to be some changes."[14]

In answer to Senator Wheeler's last remark Commissioner Mahaffie of the Interstate Commerce Commission, appearing before the Committee, replied:

"Well, I think that there should and would be no hesitancy at all."

This indicates that the Commission now believes that if some of the reorganization plans were now remanded to it, changes would have to be made in order to make them equitable in the light of existing conditions.

Although the above bill was vetoed by President Truman and did not become law, it is clear that the President did not mean to indicate that he was opposed to the aim of the legislation to prevent forfeiture of railroad securities in the reorganization process. Thus, he wrote in a Memorandum of Disapproval, dated August 13, 1946:

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(13) Hearings before the Senate Committee on Interstate Commerce on S. 1253 (79th Congress, 2nd session). (Pg. 412).

(14) *Ibid.* pg. 516.

"By withholding my signature to this bill I do not intend to indicate that I favor the pending reorganization plans. I am in agreement with those objectives of the bill which prevent undesirable control of the railroads, either immediately or within a few years, and which prevent forfeitures of securities."

Shortly afterwards four members of the House and Senate Conference Committee which wrote the vetoed version of the bill issued a statement to the effect that a revised and broadened version of the bill to meet President Truman's objections would be promptly introduced in the next session of Congress.[15]

It is highly significant that throughout the Congressional hearings and committee reports which led to the passage of this bill the reorganization plan of the present Debtor was constantly alluded to as a particularly flagrant example of erroneous elimination of equity interest. Likewise, the continuation of the trusteeship of the Debtor was referred to as particularly unconscionable in view of present improved conditions. An example is the following colloquy at the Senate Committee hearing on this bill between Senator Wheeler and Commissioner Mahaffie of the Interstate Commerce Commission:[16]

"The Chairman. It seems to me the Interstate Commerce Commission might at least make a suggestion

(15) Reported in the Wall Street Journal for August 15, 1946.

(16) Hearings before the Senate Committee on Interstate Commerce on S. 1253 (79th Cong. 1st Session), October 31, 1945, p. 10. The same conversation is incorporated at page 49 of the Senate report on the investigation of the trusteeships under section 77 of the Bankruptcy Act, S. Rep. No. 925 (79th Cong. 2nd Session). See also pages 39, 49, 50, 52, 54, 58, 60, 61 and 62 of that report for references to the Debtor's situation.

to some of the courts to the effect that some receivers or trustees or lawyers should step up matters. According to figures I have your Commission shows the Cotton Belt[17] has in 4½ years earned its annual interest charges 42 times and also about $150 a share on its stock. What possible reason can there be for keeping a road in that condition in the hands of receivers?

Mr. Mahaffie. We approved a plan in March 1942 in the case of the Cotton Belt Railroad. It was approved by the United States district court in charge of the property, but an appeal from that decision has been pending and is not yet decided. It is in the circuit court of appeals. I am not sure the circuit court of appeals would appreciate suggestions from us as to how it can do its business.

The Chairman. Well, if that railroad is bankrupt a lot of us would like to be declared bankrupt on the same basis.'"[18]

The especially excellent financial record of this Debtor during its reorganization is also emphasized by the following passage from the report of the Senate Committee on Investigation of Trusteeships under Section 77, S. Rep. 925 (79th Cong. 2nd Session), p. 39:

"Even taking only their common stock, five of the railroads above listed, still in the reorganization

(17) The popular name for the Debtor.

(18) Freeman Cleaves, a financial writer, in an article appearing in the financial section of the New York World-Telegram for April 6, 1946, (pg. 13) declares:

"The St. Louis Southwestern Railway (Cotton Belt Route) is obviously the best situated among the reorganization railroads which could be returned to the debtor corporation under bills now pending in Congress."

courts, have excelled the average for all the railroads, the bulk of them solvent in form as well as in fact. Compared with the average for the industry as a whole: Chicago, Rock Island & Pacific did one and one-half times as well; Denver & Rio Grande did one and one-half times as well; Gulf Coast Lines did two and one-third times as well; Missouri Pacific did one and one-half times as well; St. Louis Southwestern did three and one-half times as well."

This case tests whether this Court will, as assumed in *Ecker v. Western Pacific R. Corp. supra,* and *Group of Investors v. Milwaukee R. Corp, supra,* refer a railroad plan of reorganization back to the Commission because of improvement in the railroad's financial condition of any magnitude, or whether the expressions of the Court in those cases are to be deemed dicta to be now disregarded. For if any plan of reorganization is to be sent back to the Commission for reconsideration because of improvement subsequent to the Commission plan, this is it.

2. THE CIRCUIT COURT'S DECISION IS IN CONFLICT WITH THAT OF A DISTRICT COURT IN ANOTHER CIRCUIT.

The Circuit Court's decision that, despite Debtor's improvement in its net current asset picture, its substantial debt retirements and its present solvency, the plan need not be remanded to the Commission, is in sharp conflict with the recent decision of a district court in another circuit. This is the memorandum decision of June 28, 1946 of the United States District Court for the Northern District of Illinois in *In the Matter of the Chicago, Rock Island and Pacific Railway, Debtor, supra,* which is attached hereto as Appendix E. In that decision

the Rock Island reorganization was set aside on a showing of asset balance improvement and debt reduction comparable to that in the present case.

The improvement upon which Judge Igoe's decision was based in that case is described in the following two paragraphs of his decision:

> "In the present case we have a plan that except for slight modifications was prepared by the Commission in 1940 and rests on studies of earnings, etc., going back to 1937 and even beyond.
>
> Against that we find the Debtor today with cash, or equivalent of over $70,000,000.; with an R.F.C. loan aggregating, principal and interest, in excess of $18,000,000.00, paid in full; with the entire first mortgage of the Peoria Terminal Co., to all intents and purposes paid in full; with over 20% of the Choctaw & Memphis first mortgage retired; and with an amazing reduction, in the interim, of equipment debt. Three classes of creditors set up in the original Plan have disappeared—the banks, the R.F.C., and the Peoria Railway Terminal Co.

It is to be noted from an examination of this decision and the Interstate Commerce Commission's decision in that case (*Chicago, R. I. & P. Ry. Co., Reorganization*, 257 I.C.C. 307, 318) that while the Rock Island's financial improvement was impressive, that carrier had by no means attained the condition of solvency achieved by the present Debtor. The above decision of the Commission (p. 309), points out that on January 1, 1944, there was an unsatisfied deficiency of over $80,000,000 in the provision made for creditors' claims, so that as of that date the carrier may be considered insolvent by that margin. The court, in discussing subsequent improvement in the car-

rier's debt picture, speaks of the following: reduction of equipment trust certificates, payment of R.F.C. note and interest, payment of bank notes, payment of Peoria Terminal Company mortgage, and payment of about 20 percent of the Choctaw & Memphis mortgage. The Commission states (257 I.C.C. 318) that the Rock Island's equipment trust indebtedness as of January 1, 1944, was $11,909,000. As of December 31, 1945, it was $8,155,833 (Moody's Steam Railroads, 1946, pg. 386), an improvement of $3,753,167. The Commission's decision (257 I.C.C. 318) sets forth the bank indebtedness, R.F.C. indebtedness and Peoria Railway Terminal Mortgage, all described by the court as paid, respectively as follows: $6,013,629, $20,849,015 and $928,000. In addition the court states that about 20 percent of the Choctaw & Memphis mortgage had been paid off. Since the Commission's decision (257 I.C.C. 318) lists the total of that item as $5,286,000, an additional amount of $1,057,200, representing 20 percent of the above figure, should be added to the improvement column. Finally, it is to be noted that as of January 1, 1944, the Rock Island's net current asset balance was $65,332,541, whereas on December 31, 1945, it was $67,643,340, (Moody's Steam Railroads, 1946, pg. 386) an improvement of $2,310,-799. Adding the last figure to the above reduction figures gives a total improvement of about $35,000,000. This means that as of the time of the court's decision in that case the Rock Island was still insolvent by about $55,000,000. Yet its reorganization plan was set aside. On the other hand, in the present Debtor's case, a reorganization plan, which likewise eliminates stockholders, is held not inequitable, although Debtor has attained solvency by a margin of $18,600,000.

3. THE CIRCUIT COURT'S DECISION IS IN CONFLICT WITH DECISIONS OF THIS COURT.

The Circuit Court has remarked in its decision (R. 5662):

> "The fact that the physical properties, including cash and liquid securities, may have a value beyond the total indebtedness is not controlling either at the beginning or during such reorganization proceedings."

It further remarked (R. 5663):

> ". . . it is clear that the moving consideration with the Commission was earnings—as it should have been."

From these statements it is apparent that the court largely rejected solvency in the bankruptcy sense as of importance for valuation purposes in favor of an actual earnings test.

Leaving aside the fact, already shown, that the Debtor's present solvency greatly bolsters its potential earning power, it is to be recalled that, even on the basis of the court's own criterion of actual earnings, it has been amply demonstrated that the stockholders' claim is not valueless. It is apparent, therefore, that the court's decision thus amounts to the proposition that a claim which is not valueless may, nevertheless, be validly eliminated from participation in a bankruptcy reorganization plan.

Such a proposition is fundamentally opposed to the position taken by this Court in the *Western Pacific* and *Denver & Rio Grande* cases that only valueless claims may be validly eliminated. In the former case this Court said (318 U.S. at 475, 476):

". . . We hold that the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganization is in accordance with valid provisions of S. 77(e)".

In the latter case, the court remarked (90 L. Ed. at 1141):

"At this point, we restate our conclusion reached in the former cases that the Congressional authority to the Commission to eliminate valueless claims from participation in reorganization is a valid exercise of the federal bankruptcy power."

CONCLUSION

It is respectfully submitted that a writ of certiorari should issue.

Dated: January 13, 1947.

BEN C. DEY
GEORGE L. BULAND
ROBERT L. PIERCE
65 Market St.,
San Francisco 5, Calif.
CLAUDE O. PEARCY,
418 Olive St.,
St. Louis 2, Mo.
Attorneys for Petitioner.

(APPENDICES FOLLOW)

Appendix

APPENDIX A

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee

Income Account Month of October, 1946
and Ten Months 1946

	October, 1946	January 1 to October 31, 1946
RAILWAY OPERATING REVENUES:		
Freight	3 923 442 09	35 173 316 20
Passenger	141 398 97	1 571 517 14
Mail	26 811 92	259 914 08
Express	33 449 08	289 782 53
Miscellaneous transportation	27 023 73	240 709 29
Incidental	55 531 20	571 857 06
Joint facility (Net)	1 773 96	19 790 51
Total	4 209 430 95	38 126 886 81
RAILWAY OPERATING EXPENSES:		
Maint. of Way & Structures	611 348 21	6 389 177 24
Maint. of Equipment	491 143 82	5 689 629 81
Traffic	123 037 39	1 196 526 14
Transportation	1 306 092 98	12 393 453 03
Miscellaneous Operations	36 135 73	372 011 68
General	112 891 09	1 127 437 17
Total	2 680 649 22	27 168 235 07
Net rev. from ry. oper's.	1 528 781 73	10 958 651 74
RAILWAY TAX ACCRUALS:		
State, County & City taxes	82 998 87	831 222 58
Federal income tax	384 049 28	2 150 193 15
Fed.inc.tax-adj. 1941 & 1945	Cr. 47 162 98	Cr. 403 095 39
Other federal taxes	118 996 06	1 196 315 93
Total	538 881 23	3 774 636 27
Railway operating income	989 900 50	7 184 015 47
RENT INCOME:		
Rent from locomotives	-	1 740 45
Rent from pass. train cars	771 93	25 001 26
Rent from work equipment	27 00	643 54
Joint facility rent income	27 659 89	281 135 79
Total	28 458 82	308 521 04
RENTS PAYABLE:		
Hire of frt. cars-Dr. bal.	74 292 71	995 685 83
Rent for locomotives	6 90	29 94
Rent for pass. train cars	55 162 05	84 012 86
Rent for work equipment	-	274 75
Joint facility rents	79 070 71	755 267 72
Total	208 532 37	1 835 271 10
Net rents - Debit	180 073 55	1 526 750 06
Net railway optg. income	809 826 95	5 657 265 41

Continued on next page

Appendix

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee

Income Account Month of October, 1946
and Ten Months 1946

	October, 1946	January 1 to October 31, 1946
Brought forward	809 826 95	5 657 265 41
OTHER INCOME:		
Income from lease of rd. & equip.	836 26	8 362 60
Miscellaneous rent income	2 383 94	36 587 93
Misel. nonoptg. phys. property	961 50	11 281 85
Income from funded securities	4 329 86	35 553 60
Income from unfd. sec. & accts.	15 920 00	218 617 93
Miscellaneous income	136 22	1 009 58
Total	24 567 78	311 413 49
Total income	834 394 73	5 968 678 90
MISCELLANEOUS DEDUCTIONS FROM INCOME:		
Miscellaneous rents	29 00	316 41
Miscellaneous tax accruals	656 26	656 26
Maint. of invest. organization	-	201 10
Misel. income charges	5 910 40	17 873 66
Total	6 595 66	19 047 43
Inc. avail. for fixed chgs.	827 799 07	5 949 631 47
FIXED CHARGES:		
Rent for leased roads & equip.	1 146 81	11 248 18
Interest on funded debt (fixed)	249 852 89	2 483 068 37
Interest on unfunded debt	162 46	9 229 80
Total	251 162 16	2 503 546 35
Net income	576 636 91	3 446 085 12
DISPOSITION OF NET INCOME:		
Bal. of inc. transferred to Earned Surplus	576 636 91	3 446 085 12

St. Louis, Missouri, December 11, 1946

Appendix

CERTIFIED COPY

D. C. Form No. 30

United States of America
Eastern District of Missouri } ss:

I, James J. O'Connor, Clerk of the United States District Court in and for the Eastern District of Missouri, do hereby certify that the annexed and foregoing is a true and full copy of the original Income Account for October 1946 and ten months of 1946, filed December 11, 1946 with STATEMENTS OF ASSETS AND LIABILITIES OF THE DEBTORS AS OF OCTOBER 31, 1946, AND CONSOLIDATED STATEMENT OF REVENUES AND EXPENSES OF THE DEBTORS FOR THE MONTH OF OCTOBER, 1946, In the Matter of St. Louis Southwestern Railway Company, Debtor, In Proceedings For the Reorganization of a Railroad, No. 5997, and

now remaining among the records of the said Court in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at St. Louis, Missouri this 11th day of December, A. D. 1946

JAMES J. O'CONNOR
Clerk.

By Annina W. Kinder
Deputy Clerk.

No. 8497

United States District Court

Eastern DISTRICT OF Missouri

In the matter of

St. Louis-Southwestern Railway Company,

Debtor.

CERTIFIED COPY

APPENDIX B

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee
COMPARATIVE GENERAL BALANCE SHEET OCT., 1946-1945 ELIMINATING INTER-COMPANY ITEMS

ASSETS	Oct. 31, 1946	Oct. 31, 1945	+ Increase - Decrease
INVESTMENTS			
Road and equipment property	$136 538 870 43	$135 861 264 40 +	677 606 03
Improvements on leased property	38 443 24	33 708 52 +	4 734 72
Less:			
Donations and grants	317 830 86	309 028 72 +	8 802 14
Accrued depreciation-Road	591 070 73	814 808 71 -	223 737 98
Accrued depreciation-Equipment	11 892 479 48	11 513 581 46 +	378 898 02
Acod.amort.of defense projects-Rd	1 356 404 75	897 042 49 +	459 362 26
Acod.amort.of defense projects-Eq	4 322 914 16	3 082 133 06 +	1 240 781 10
Net investment in Road & Equip	118 096 613 71	119 278 378 48 -	1 181 764 77
Capital and other reserve funds	160 186 65	120 186 65 +	40 000 00
Miscellaneous physical property	275 368 28	281 286 15 -	5 917 87
Investments in affiliated companies:			
(A) Stocks	2 447 507 00	2 447 507 00	-
(B) Bonds	816 004 00	816 004 00	-
(C) Other secured obligations	7 376 27	90 585 48 -	83 209 21
(E) Investment advances	1 213 812 56	1 218 573 38 -	4 760 82
Other investments:			
(A) Stocks	54 48	54 48	-
(B) Bonds			
Second Mortgage Income Bonds	6 957 500 00	6 957 500 00	-
(E) Advances	8 112 69	- +	8 112 69
Total investments	129 982 535 64	131 210 975 62 -	1 227 539 98
CURRENT ASSETS			
Cash	1 281 303 54	743 917 11 +	537 386 43
Temporary cash investments	21 708 620 00	32 840 625 00 -	11 132 005 00
Special deposits	1 385 961 75	1 336 321 15 +	49 640 60
Traffic and car-service balance-Dr	1 944 736 64	773 373 84 +	1 171 362 80
Net bal.receivable from agts.& conds	468 468 81	363 176 09 +	105 292 72
Miscellaneous accounts receivable	1 499 962 53	2 439 367 64 -	939 405 11
Material and supplies	4 110 997 63	4 490 108 69 -	379 111 06
Interest and dividends receivable	16 800 00	16 800 00	-
Accrued accounts receivable	104 913 48	447 256 29 -	342 342 81
Excess profits tax refund bonds	-	744 072 80 -	744 072 80
Other current assets	24 083 08	16 127 69 +	7 955 39
Total current assets	32 545 847 46	44 211 146 30 -	11 665 298 84
DEFERRED ASSETS			
Working fund advances	39 476 49	38 566 61 +	909 88
Insurance and other funds	76 500 00	- +	76 500 00
Post war refund credit	-	3 002 648 97 -	3 002 648 97
Other deferred assets	28 393 69	27 562 02 +	831 67
Total deferred assets	144 370 18	3 068 777 60 -	2 924 407 42
UNADJUSTED DEBITS			
Prepayments	22 536 99	13 806 40 +	8 730 59
Other unadjusted debits	741 071 67	349 113 35 +	391 958 32
Total unadjusted debits	763 608 66	362 919 75 +	400 688 91
GRAND TOTAL	163 436 361 94	178 852 919 27 -	15 416 557 33

ST. LUCIA CO-OPERATIVE CREDIT UNION
Anytown Branch, Treetop
CONSOLIDATED FINANCIAL BALANCE SHEET OF ... AND ALL ITS SUBSIDIARIES OVER ... YEARS
(000's omitted)

ASSETS	20..	20..	20..	20..	20..
CURRENT ASSETS					
Cash and equivalents (treasury)					
Investments in Income properties					
Loans:					
Overdue and pledge					
Secured Depreciation-Equipment					
Secured Depreciation-Equipment					
Accounts receivable Medicare provider-Dr					
Accounts receivable Patients provider-Dr					
Due investments in fund & Equip					
Capital and other reserve funds					
Intellectual physical property					
Investments in affiliated companies:					
(A) Stocks					
(B) Bonds					
(C) Other secured obligations					
(D) Unsecured advances					
Other investments:					
(A) Stocks					
(B) Bonds					
Unsecured foreign income bonds					
(C) Advances					
Total investments					
CURRENT LIABILITIES					
Loans					
Temporary bank overdrafts					
Special deposits					
Profits and contingencies					
Net Del Corporation & Corp Equity					
Allowance for doubtful accounts					
Retained and undistributed					
Current portion of long-term debt					
Current portion of long-term debt					
Current portion of long-term debt					
Current portion of long-term debt					
Current portion of long-term debt					
Current portion of long-term debt					
Other current liabilities					
DEFERRED CREDITS					
Reserve for contingencies					
Income taxes					
Other deferred credits					
SHAREHOLDERS' EQUITY					
Preferred stock					
Common stock					
Retained earnings					
Total shareholders' equity					

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee
COMPARATIVE GENERAL BALANCE SHEET OCT., 1946-1945 ELIMINATING INTER-COMPANY ITEMS

	Oct. 31, 1946	Oct. 31, 1945	+ Increase - Decrease
LIABILITIES			
Capital stock - Common	$ 17 186 100 00	$ 17 186 100 00	$ -
Preferred	19 893 600 00	19 893 600 00	-
Total stock	37 079 700 00	37 079 700 00	-
LONG TERM DEBT			
Funded debt unmatured:			
First Mortgage Bonds	20 950 000 00	20 950 000 00	-
Second Mortgage Income Bonds	10 000 000 00	10 000 000 00	-
Texarkana Union Sta.Tr.Ctfs.Ser."A".	315 000 00	315 000 00	-
Debt in default:			
First Mortgage Bonds	3 173 894 68	3 173 894 68	-
First Terminal & Unify.Mtg.Bonds	8 063 000 00	8 063 000 00	-
Gen.& Ref.Mtg.5% Gold Bds.Series"A".	9 327 500 00	9 327 500 00	-
The Chase Natl.Bk.of the City of N.Y.	3 500 000 00	3 500 000 00	-
Mississippi Valley Trust Co.	1 000 000 00	1 000 000 00	-
The Railroad Credit Corporation	-	503 955 33 -	503 955 33
Amounts payable to affiliated companies:			
Notes-RFC-Purchased by Sou.Pac.Co.	17 882 250 00	17 882 250 00	-
Open Accounts-Southwestern Transp.Co.	890 289 51	890 289 51	-
The S.W.Town Lot Corp.	20 444 97	19 162 79 +	1 282 18
Total long term debt	75 122 379 16	75 625 052 31 -	502 673 15
CURRENT LIABILITIES			
Audited accounts and wages payable	1 814 177 14	2 071 549 81 -	257 372 67
Miscellaneous accounts payable	258 322 37	230 856 21 +	27 466 16
Interest matured unpaid	1 173 203 15	1 186 056 31 -	12 853 16
Unmatured interest accrued	63 170 82	22 604 16 +	40 566 66
Accrued accounts payable	58 711 50	70 532 29 -	11 820 79
Taxes Accrued:			
State, county and city taxes	689 423 17	743 507 16 -	54 083 99
Federal income tax	6 021 755 77	20 197 217 28 -	14 175 461 51
Other federal taxes	126 848 24	123 942 93 +	2 905 31
Other current liabilities	249 730 76	188 168 52 +	61 562 24
Total current liabilities	10 455 342 92	24 834 434 67 -	14 379 091 75
DEFERRED LIABILITIES			
Interest in default:			
First Term.& Unify.Mtg.Bonds	134 383 33	134 383 33	-
Gen.&Ref.Mtg.5% Gold Bds.Series"A"	2 020 958 33	2 487 333 33 -	466 375 00
Cent.Ark.and East.RR.Co.1st Mtg.Bds.	265 202 93	265 202 93	-
S.W.& S.T.Ry.Co. First Mtg.Bonds	601 611 48	601 611 48	-
Reconstruction Finance Corporation	1 443 540 80	2 958 688 30 -	1 515 147 50
Others	225 130 41	635 607 06 -	410 476 65
Other deferred liabilities	199 620 04	193 791 34 +	5 828 70
Total deferred liabilities	4 890 447 32	7 276 617 77 -	2 386 170 45
UNADJUSTED CREDITS			
Other unadjusted credits	390 514 21	310 139 04 +	80 375 17
Accrued depreciation-Leased property	143 448 54	110 050 27 +	33 398 27
Total unadjusted credits	533 962 75	420 189 31 +	113 773 44
SURPLUS			
Earned surplus-Appropriated	-	4 898 148 73 -	4 898 148 73
Earned surplus-Unappropriated	35 354 529 79	28 718 776 48 +	6 635 753 31
Total surplus	35 354 529 79	33 616 925 21 +	1 737 604 58
GRAND TOTAL	162 436 361 94	178 852 919 27 -	15 416 557 33

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D. C. Form No. 30

United States of America
ss:
Eastern District of Missouri

I, James J. O'Connor, Clerk of the United States District Court in and for the Eastern District of Missouri, do hereby certify that the annexed and foregoing is a true and full copy of the original Comparative General Balance Sheet as of October 31, 1946 and 1945 Eliminating Inter-Company Items, filed December 11, 1946 with STATEMENTS OF ASSETS AND LIABILITIES OF THE DEBTORS AS OF OCTOBER 31, 1946, AND CONSOLIDATED STATEMENT OF REVENUES AND EXPENSES OF THE DEBTORS FOR THE MONTH OF OCTOBER, 1946, In the Matter of St. Louis Southwestern Railway Company, Debtor, In Proceedings For the Reorganization of a Railroad, No. 8497, and

CERTIFIED COPY

now remaining among the records of the said Court in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of the aforesaid Court at St. Louis, Missouri this 11th day of December, A. D. 1946

JAMES J. O'CONNOR
Clerk.

By Annie W. Kimbles
Deputy Clerk.

No. 8497

United States District Court

Eastern DISTRICT OF Missouri

In the Matter of
St. Louis Southwestern Railway
Company,
Debtor.

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APPENDIX C

—10429—

[Order No. 904]

In the

DISTRICT COURT OF THE UNITED STATES,

Eastern Division, Eastern Judicial District of Missouri.

In the Matter of	**In Proceedings for the**
ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, Debtor.	**Reorganization of a Railroad. No. 8497.**

ORDER

Authorizing Trustee to Participate in Retirement of Texarkana Union Station Trust Certificates.

The petition of Berryman Henwood, Trustee of the property of the principal Debtor St. Louis Southwestern Railway Company, and of the Debtor St. Louis Southwestern Railway Company of Texas, for authority to participate with the other proprietary companies in calling and retiring Texarkana Union Station 5% Trust Certificates, due December 1, 1957, at a premium of 7½%, and at a cash outlay to the

Trust Estate of the Debtors in the amount of $346,500.00, being this day presented to the Court, and it appearing that the notice of the filing of said petition has been served upon the mortgage trustees of the Debtors and their counsel, and upon interveners herein, and upon other parties in interest who are on the mailing list of Trustee accustomed to receive printed copies of the orders entered in these proceedings, and all parties in interest having been heard or having been given an opportunity to be heard, and it appearing that the retirement of said Trust Certificates is in the best interest of the Trust Estate, and the Court being fully advised in the premises,

It Is Ordered:

That the said petition be and the same hereby is approved, and the Trustee is authorized and directed to participate with the other proprietary companies in calling and retiring on December 1, 1946, $1,500,000 par value of Texarkana Union Station 5% Trust Certificates, at an expense to the Trust Estate of the Debtors herein of $346,500.00, as more fully set out in Trustee's petition pursuant to which this order is entered, and the said Trustee is authorized and empowered to do all things requisite and necessary in the premises.

GEO. H. MOORE,
District Judge.

Dated September 13, 1946.

Filed Sept. 13, 1946. Jas. J. O'Connor, Clerk.

APPENDIX D

— 10471 —

[Order No. 909]

In the

DISTRICT COURT OF THE UNITED STATES,

Eastern Division, Eastern Judicial District of Missouri.

In the Matter of ST. LOUIS SOUTHWESTERN RAILWAY COMPANY, Debtor.	In Proceedings for the Reorganization of a Railroad. No. 8497.

ORDER

Authorizing and Directing Trustee to Pay Claim of the Railroad Credit Corporation.

The petition of Berryman Henwood, Trustee of the property of the principal Debtor St. Louis Southwestern Railway Company, and of the other Debtors herein, for authority to pay the claim of The Railroad Credit Corporation, evidenced by note, being this day presented to the Court, and it appearing that notice of the presentation of said petition has been served upon the mortgage trustees of the Debtors

APPENDIX B

[Order No. 309]

In the

DISTRICT COURT OF THE UNITED STATES,

Eastern Division, Eastern Judicial District

of Missouri.

In Proceedings for the Reorganization of a Railroad No. 6897.

In the Matter of

ST. LOUIS SOUTHWESTERN RAILWAY COMPANY,

Debtor.

ORDER

Authorizing and Directing Trustee to Pay Claim of the Railroad Credit Corporation.

The petition of Berryman Henwood, Trustee of the property of the debtor St. Louis Southwestern Railway Company, and of the other Debtors herein, for authority to pay the claim of The Railroad Credit Corporation, evidenced by note, being this day presented to the Court, and it appearing that notice of the filing of said petition has been served upon the mortgage trustees of the Debtors and their counsel, and upon intervenors

and their counsel, and upon interveners herein, and upon other parties in interest who are on the mailing list of the Trustee accustomed to receive printed copies of the orders entered in these proceedings, which notice the Court finds sufficient, and all parties in interest having been heard or having been given an opportunity to be heard, and the Court being fully advised in the premises, finds:

1. That as of July 31, 1946, the Debtor herein was indebted to The Railroad Credit Corporation in the principal amount of $382,249.06; that interest thereon has been paid to July 31, 1946, said amount representing the principal unpaid balance remaining due on account of certain advances made to the Debtor by The Railroad Credit Corporation and evidenced by principal Debtor's promissory note of April 1, 1934, in the face amount of $1,367,875.00, said indebtedness having been reduced from time to time by cash payments and payments of amounts credited to the Debtor as its distributive shares under the Marshalling and Distributing Plan, 1931, whereby The Railroad Credit Corporation received various sums from the railroads of the country and loaned therefrom amounts needed by certain railroads to meet their fixed interest charges, said amounts when repaid being distributed to those railroads which provided the funds and in the proportions so provided by them.

2. That as collateral security for the indebtedness of the Debtor herein, The Railroad Credit Corporation holds certain obligations of the Debtor and its subsidiaries, to-wit: Valley Terminal Railway Com-

— 10172 —

pany Common Stock of a par value of $5,000.00; Valley Terminal Railway Company Bills Receivable of a face value of $840,431.64; The Southwestern Town Lot Corporation Common Stock of a par value of $100,000.00; The Southwestern Town Lot Corporation Advances of a face value of $846,843.45; Southwestern Transportation Company Capital Stock of no par value but with a book value of $1,481,100.00; Arkansas & Memphis Railway Bridge & Terminal Company Preferred Stock of a par value of $550,000.00; Southwestern Greyhound Lines, Inc., Class B Common Stock, of no par value but with a book value of $160,000.00.

3. That in the Plan of Reorganization proposed by the Interstate Commerce Commission in its Report and Order of June 30, 1941, and in its Supplemental Report and Order dated March 9, 1942, and in the opinion of this Court and order thereon approving said Plan of Reorganization under date of February 9, 1944, confirmed by the Circuit Court of Appeals in opinion dated August 26, 1946, the claim of The Railroad Credit Corporation has been consistently recognized as fully secured and entitled to payment.

4. That payment in full of this claim at this time will not materially affect or modify the aforesaid Plan of Reorganization and will not in any way hinder or impede the reorganization of the Debtor, but on the contrary will facilitate the same through the removal of a secured creditor, and the necessity for the making of a provision for the payment of this claim, as well as a saving to Debtors' Estate of the further accrual of interest.

—10474—

Wherefore, it is hereby ordered:

That the said petition be and the same hereby is approved, and the Trustee is ordered and directed to pay in cash to said The Railroad Credit Corporation the amount due and unpaid on the promissory note of the principal Debtor dated April 1, 1934, together with accrued and unpaid interest thereon to date of payment upon delivery to said Trustee by said The Railroad Credit Corporation of the cancelled promissory note of St. Louis Southwestern Railway Company, Debtor, dated April 1, 1934, in the principal amount of $1,367,875.00, the pledge of said principal Debtor's distributive shares in the Marshalling and Distributing Plan, 1931, and the surrender to the Trustee of all of the collateral security, consisting of certain obligations of the Debtor and its subsidiaries as particularly set out in paragraph 2 herein, and the Court hereby expressly reserves jurisdiction to make such further order or orders as may be deemed necessary in the premises.

GEO. H. MOORE,
District Judge.

Dated September 25th, 1946.

Filed Sept. 25, 1946. Jas. J. O'Connor, Clerk.

APPENDIX E

5613

[MEMORANDUM OPINION AND ORDER No. 420.]
(FILED AND ENTERED JUNE 28, 1946.)

IN THE

DISTRICT COURT OF THE UNITED STATES

FOR THE NORTHERN DISTRICT OF ILLINOIS,
EASTERN DIVISION.

IN PROCEEDINGS FOR THE REORGANIZATION OF A RAILROAD.

In the Matter of
THE CHICAGO, ROCK ISLAND AND PACIFIC RAILWAY COMPANY,
Debtor.
No. 53209.

MEMORANDUM OPINION.

Confirmation is sought by these proceedings of the Plan of Reorganization for the Debtors, as modified and approved by the Interstate Commerce Commission, hereinafter called the "Commission", in its Supplemental Report and Order of May 1, 1944.

Certification has been made heretofore to this Court by the Commission of the results of the submission to the various classes of creditors entitled to vote on the Plan. An approval of the plan in excess of a two-thirds majority was expressed by each class of creditors, save two; the Convertible Debenture bondholders whose vote for approval was slightly in excess of 24% and the Little Rock and Hot Springs Western Bondholders whose vote for approval amounted to 19%.

Subsection (e) of Section 77 of the Bankruptcy Act makes

it mandatory upon the Court to confirm the Plan if more than two-thirds of all classes of creditors concerned so vote. Said subsection likewise "provides that, if the plan has been rejected, 'the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e)'."

Said clause (1) of the first paragraph of subsection (e) provides that the Court may approve a plan if satisfied that it is "fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors and stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders."

Subsection (e) further provides that if the Judge shall not confirm the Plan he shall file an opinion with a statement of his conclusions and his reasons therefor and enter an order in which he shall either dismiss the proceedings, or in his discretion and on the motion of any party in interest refer the case back to the Commission for further proceedings, including the consideration of modifications of the Plan or the proposal of new plans.

Before proceeding further the Court wishes to divert for a moment and point out what has transpired in the interval following the approval of the Plan on June 15, 1945 by this Court, and the present.

An ever growing wave of criticism directed against the Commission and the District Courts for the drastic reduc-

tions in capitalization effected by their plans of reorganization finally culminated in Congress giving extensive study to proposed remedies.

Exhaustive hearings were held by committees of both Houses of Congress and in the hearings before the Committee on Interstate Commerce of the Senate, during February and March of this year, many new ideas were advanced regarding the subject of railroad reorganization culminating in the passage of Senate Bill 1253 on June 15, 1946—which bill now awaits House consideration.

Apropos of the widespread dissatisfaction with these reorganizations let me quote from the printed record of the hearings which were held in connection with Senate Bill 1253.

Senator Wheeler, Chairman of the Committee, stated in the printed record (p. 516):

"If you had not had these changed conditions (the improvement of railroad finances during the war years) there would not have been this complaint we have from all the country, from stockholders and bondholders and everybody else. I just don't believe that the Commission ought to hesitate at all to say that in view of the changed conditions there ought to be some changes."

To which Commissioner Mahaffie of the Interstate Commerce Commission agreed by saying:

"Well, I think that there should * * * be no hesitancy at all."

And the Senator goes on (p. 412):

"The reason we have tried to work out something in this committee is because of the terrific pressure that has been put on the committee and the Congress by Members of the Senate and their own constituents to pass the Hobbs bill. We have tried to work out something not as drastic as the Hobbs bill."

It must be remembered, in fairness, that practically all of the major plans of reorganization were worked out by the Commission in the year 1940 or prior thereto. Hence they do not and cannot reflect the extensive strengthening of cash resources, the important retirement of debt, and the very considerable improvements to road and equipment made possible by the huge revenues received during the ensuing war years.

It must be remembered further, that since the Milwaukee and Western Pacific decisions of the U. S. Supreme Court, undoubtedly most District Courts throughout the land, and certainly this Court, have been firmly convinced of their legal incapacity to pass upon matters of valuation or allocation of securities as set out in plans of reorganization certified to them by the Commission.

Likewise, the Commission sensing the need for changes as the war years went on were undoubtedly loath to ask the District Courts for the return of their plans, feeling that they had passed out of their jurisdiction unless returned to them by the Courts. In proof of this may this Court again advert to the Senate hearings mentioned before.

In his testimony Commissioner Mahaffie states (p. 515):

"The Commission has considered that after a plan has been certified by it to the court having jurisdiction, the question of whether conditions had so changed as to require its resubmission with a view to possible revision is one for the court. And that the Court's determination is wholly a matter of judicial discretion. Consequently the Commission has felt that it should not volunteer advice to the courts in that regard."

To this Chairman Wheeler replied (p. 515):

"While I can readily appreciate that the Commission might hesitate somewhat to ask the Court to return a plan some courts might possibly resent it, nevertheless I think I

would have taken a chance on it if I had been in the position of the Commission.

"On the other hand you may have had a situation where the courts were reluctant to send a plan back to the Commission. * * * In the meantime some of these securities were wiped out of existence. I just don't believe that the Commission on the one hand or the courts on the other hand, when an injustice is being done, should stand upon the question of mere fear that they are perhaps going to offend each other."

Only a few days ago when Senate Bill 1253 was under debate Senator Wheeler stated:

"Let us consider the matter from the social standpoint. If we have another depression in this country we are bound to be faced with the same grave social problems. What do Senators believe the people of the country will think of Government agencies which permit the wiping out of $2,500,000,000 worth of railroad stock, a considerable portion of which was owned by working men and women, by widows and orphans, while at the same time bonds which had been selling as low as $2.50 rose to par or over, by reason of the fact that the guess made by the Interstate Commerce Commission resulted in wiping out the stocks? What are those who lost by reason of that guess going to think of that Government agency?

"Time and again on the floor of the Senate I have defended the Interstate Commerce Commission, but I say that the Commission should have said to the courts:

"'We are going to call back the plans affecting these railroads now in receivership, revamp them, make them conform to the facts and realities, and try to have the railroads operated for the benefit of those who own the roads.'

"But they did not do that. The result is that those who held the senior securities which they bought in some cases

at as low as $2.50 now have bonds worth up to $80 or $90 or even $100."

Congressional Record—Senate, June 15th, 1946 (p. 7114).

I am in accord with the sentiments of Senator Wheeler. We must be realistic. In the face of possible injustice no one should stand on ceremony.

In the present case we have a plan that except for slight modifications was prepared by the Commission in 1940 and rests on studies of earnings, etc., going back to 1937 and even beyond.

Against that we find the Debtor today with cash, or equivalent of over $70,000,000.; with an R.F.C. loan aggregating, principal and interest, in excess of $18,000,000.00, paid in full; with the entire first mortgage of the Peoria Terminal Co., to all intents and purposes paid in full; with over 20% of the Choctaw & Memphis first mortgage retired; and with an amazing reduction, in the interim, of equipment debt. Three classes of creditors set up in the original Plan have disappeared—the banks, the R.F.C., and the Peoria Railway Terminal Co.

The above recital does not take into account the tremendous sums expended over the period on improvement of road and equipment, nor does it include the retirement of debt on jointly owned facilities such as the Joliet and Denver terminals.

Certain it is that if Congress and the Commission now feel that reorganization plans prepared prior to the war did not properly evaluate the financial benefits flowing from the revenues of the war years, then this present case merits further review and consideration.

The various bills presented in, and hearings held by Congress open up a new vista of hope for the junior creditors and stockholders of the bankrupt railroad corporations.

However, in holding out hope to the junior creditors and

stockholders, this court, above all, would not have that hope illusory. The Commission cannot throw to the winds all consideration of future earnings, nor can it perform miracles. The war revenues are past, higher costs of labor and materials, and many other new problems beset railroad management. With the most optimistic approach by the Commission it would be vain for the junior creditors to expect to be made whole.

It would seem, with the sound background that exists, this Court's trustees, by making use of available cash, together with the proceeds of a conservative loan to be approved by the Commission and this Court, should be able to pay, at equitable prices, the General Mortgage and all of the relatively small divisional first mortgages.

This would achieve for the First and Refunding Mortgage, the Secured Bondholders, and all junior security holders a greater strengthening of their position and a chance for all to share to a larger degree in the securities of the reorganized company. Such a program would be in line with the debt retirement by trustees so strongly urged by the Chairman of the Senate Committee and would have the undoubted cooperation of the Commission.

Accordingly, in view of the dissenting vote of two classes of creditors, and in further view of what has been here said, the plan is not confirmed.

ENTER:

MICHAEL L. IGOE,
United States District Judge.

Appendix F

SECTION 77 (e) OF THE BANKRUPTCY ACT (11 U.S.C. 205 (e)) PROVIDES AS FOLLOWS:

Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearings, are reasonable, are within such maximum limits as are fixed by the Commis-

sion, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of sub-section (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summariza-

tion thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further,* That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed

to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided,* That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further,* That if, in any reorganization proceed-

ing under this section the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further,* That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commis-

sion shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.